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Supreme Court of the United States

OCTOBER TERM 1946

No. 791...

IN PROCEEDINGS FOR THE REORGANIZATION OF A RAILROAD.

IN THE MATTER

of

THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,
Debtor,

GERALD AXELROD, *et al.*, constituting a Group of Individual Owners of the 4½% Convertible Gold Bonds of the above-named Debtor, dated May 1, 1930,
Petitioners,

v.

JOSEPH B. FLEMING and AARON COLNON, as Trustees of The Chicago, Rock Island and Pacific Railway Company, *et al.*,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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INDEX

	PAGE
Opinions Below	2
Jurisdiction	3
Statute Involved	4
Introductory Statement of Matter Involved	4
Statement	6
Questions Presented	10
Reasons Relied on for Allowance of the Writ	11
Conclusion	11

BRIEF IN SUPPORT OF PETITION:

Opinions Below	13
Jurisdiction	14
Statement of Case	16
Specification of Errors	16
Summary of Argument	18
Conclusion	28
Appendix "A"	29
Appendix "B"	29

CITATIONS

Buffum v. Barceloux Co., 289 U. S. 227	19
Central Railroad Co. of New Jersey, In re, 136 F. (2d) 633 (cert. denied 320 U. S. 805)	20
Chase Nat'l. Bank, et al. v. Chicago, Rock Island & P. R'y. Co., 294 U. S. 648	6

PAGE

Chicago, Rock Island & Pacific Railway Co.
In re 157 F. (2d) 241 ..... 2, 13
155 F. (2d) 889 ..... 3, 14
175 ICC 46 6
242 ICC 298 13
247 ICC 533 7
257 ICC 265 17

Commr. of Internal Revenue v. Bedford's Estate, 325 U. S. 283 16
Ecker v. Western Pacific R'y Co., 318 U. S. 448 ..... 21, 23

Fierman v. Seward Nat'l. Bank of N. Y., 61 F. (2d) 952 (cert. denied 288 U. S. 613) 20

Gypsy Oil v. Escoe, 275 U. S. 498 15

Institutional Investors v. Chicago, Milwaukee, St. Paul & P. R'y Co., 318 U. S. 523 24
In the Matter of The Chicago, Rock Island & Pacific Railway Co., 157 F. (2d) 241 ..... 2, 13
155 F. (2d) 889 ..... 3, 14
175 ICC 46 6
242 ICC 298 13
247 ICC 533 7
257 ICC 265 17

In re Central R. Co. of New Jersey, 136 F. (2d) 633 (cert. denied 320 U. S. 805) 20
In re Times Square Auto Supply Co., 47 F. (2d) 240 (cert. denied, 283 U. S. 856) 20

Jackson v. Smith, 254 U. S. 586 19

Leishman v. Associated Electric Co., 318 U. S. 203 ... 15

Magruder v. Drury, 235 U. S. 106 19
Market Street R'y. v. Railroad Comm'n. of California, 324 U. S. 548 15
Meinhard v. Salmon, 249 N. Y. 458, 164 N. E. 545 19

Pfister v. Northern Illinois Fin. Corp., 317 U. S. 144 .. 15

PAGE

Reconstruction F. Corp'n. v. Denver and Rio Grande W. R. R. et al., 66 Sup. C't. 1282 27

Times Square Auto Supply Co., In re, 47 F. (2d) 240 (cert. denied, 283 U. S. 856) 20

U. S. v. Dunn, 268 U. S. 121 19

Vanston Bondholders Protective Committee v. Green, U. S. Sup. Ct. Bulletin 2

Zimmern v. U. S., 298 U. S. 167 16

STATUTES

Bankruptcy Act, Section 24(c) 3
Section 60 19
Section 77 .....3, 10, 18
Section 77(b) 17
Section 77(e) 17, 20, 21, 27
Section 77(d) 20, 21

Judicial Code, 240 (a) 3
8 (a) 16

FIFTH AMENDMENT TO CONSTITUTION OF THE UNITED STATES 3, 4, 20

APPENDIX

A. Fifth Amendment to the Constitution 29

B. Pertinent Provisions of the Bankruptcy Act,
Sec. 24(c) 29
Sec. 77(b) 29
Sec. 77(d) 31
Sec. 77(e) 32

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

TO THE HONORABLE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioners, a group of nineteen (19) individual holders and owners of the 4½% Convertible Gold Bonds

issued by the above named Debtor on May 1, 1930 to become due May 1, 1960, respectfully pray that a writ of certiorari issue to review the order and interlocutory decree of the United States Circuit Court of Appeals for the Seventh Circuit which was entered in the above cause on May 23, 1946 modified June 20, 1946, and which affirmed an order of the United States District Court for the Northern District of Illinois, Eastern Division, entered June 15, 1945 approving a plan of reorganization of the Debtor.

In this petition, your petitioners rely upon the Transcript of Record filed by the Debtor in this Court, October Term—1946, No. 410, and all references to the Transcript of Record ("R") are to that record. Additional Transcript of Record filed by these petitioners is referred to as "Add R".

This petition is also related to the petition for writ of certiorari filed in this Court by the Trustees for the Debtor where certain respondent creditors (*i. e.* Choctaw & Memphis bonds) are allowed interest upon interest by the same Circuit Court on their claims in cash. (October Term—1946, No. 454). This Court is opposed to permitting such a claim to share in the assets of an insolvent debtor. (*Vanston Bondholders Protective Committee* v. *Green,* U. S. Sup. Ct. Bulletin, p. 255, per Black, J., Dec. 9, 1946.)

Opinions Below

The opinion of the United States District Court for the Northern District of Illinois, Eastern Division (R. 301-308) was filed on May 14, 1945; it has not been reported. The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 343-355) was filed on May 23, 1946 and is reported in 157 F. (2d) 241. Also directly related to this petition is the opinion of said Circuit Court relating to the Choctaw & Memphis bonds, a leased line, whose claims for compound interest against this

Debtor are separately treated and found in 155 F. (2d) 889. (See petition for writ of certiorari filed in this Court, October Term—1946, No. 454.)

After the entry of the above interlocutory order of the Circuit Court of Appeals and the rejection of the plan of reorganization by two classes of creditors entitled to vote thereon, including the class of bonds represented by these petitioners, the District Court held a hearing to determine whether said approved plan should be confirmed. Thereafter, and on June 28, 1946, an opinion denying confirmation was filed by the District Court. Said opinion has not been reported but a true copy thereof is found in the additional transcript of record.

The Interstate Commerce Commission has, by order dated July 18, 1946, reopened the proceedings and assigned the same for public hearing for January 7, 1947. A true copy thereof is found in the additional transcript of record.

Jurisdiction

The opinion, order and interlocutory decree of the United States Circuit Court of Appeals for the Seventh Circuit sought to be reviewed, was entered on May 23, 1946 and modified on June 20, 1946, by striking out one paragraph from the opinion (R. 343-356).

On September 18, 1946, said Circuit Court entered an order staying the issuance of its mandate thereon until the disposition by this Court of petitions for writs of certiorari (Add. R. 148).

Jurisdiction of this Court is invoked under the Fifth Amendment of the Constitution of the United States; also under the provisions of Sections 77 and 24(c) of the Bankruptcy Act and Section 240(a) of the Judicial Code.

Jurisdiction of this Court is also invoked by reason of the apparent conflict in the opinion and interlocutory order

of said Circuit Court of May 23, 1946 as modified on June 20, 1946 approving a plan of reorganization for the Debtor and the opinion and intermediate order of the District Court subsequently rendered on June 28, 1946, denying confirmation to said approved plan of reorganization and referring the case back to the Interstate Commerce Commission for modification or the consideration of new plans.

The said interlocutory decree of the Circuit Court of Appeals is likewise in apparent conflict with the order of the Interstate Commerce Commission made and dated July 18, 1946, reopening the case for public hearing for the modification of the present plan and the consideration of new plans of reorganization for the Debtor (Add. R. 143-146).

Appeals from the order of the District Court of June 28, 1946 denying confirmation, taken by respondents directly to the United States Circuit Court of Appeals for the Seventh Circuit, seeking to by-pass the action of the Commission makes it necessary to bring this petition at this time.

Pending the disposition by the Courts of the apparent conflict in status of this proceeding, the Interstate Commerce Commission has upon application of respondents postponed its public hearings on the plan to January 7, 1947.

Statute Involved

The language of the Fifth Amendment to the Constitution of the United States and the pertinent provisions of the Bankruptcy Act, as amended, are found in the Appendix (pp. 29-33, *infra*).

Introductory Statement of Matter Involved

The interest of your petitioners in seeking certiorari springs from the fact that the Convertible Bondholders

Group, full parties to the proceeding in the District Court and before the Interstate Commerce Commission, are the only spokesmen for this $32,228,000 issue of bonds, the fourth largest creditor class and that said bondholders have, by reason of denial of their day in Court on the hearing of objections to the I. C. C. plan of reorganization and the unfair and inequitable treatment in the allocations of cash and securities made to them in the plan of reorganization approved by the Court, been deprived of their property without due process of law.

In order to bring the record up to date, this Court's attention is called to the fact that after hearing of objections duly presented by petitioners, to the confirmation of the approved plan of reorganization, an opinion was rendered and an order was entered by the United States District Court for the Northern District of Illinois, Eastern Division on June 28, 1946, that the plan of reorganization be not confirmed and that the case be referred back to the Interstate Commerce Commission for further proceedings. Consonant with the opinion and order of said Court, one of the trustees for the Debtor appointed by the District Court, the Convertible Bondholders Group, petitioners, and others have submitted proposals and suggested modifications to the approved plan and same are now before the Interstate Commerce Commission and the District Court.

However, since this honorable Court may be of opinion that the previous order and interlocutory decree of the United States Circuit Court of Appeals entered May 23, 1946 (R. 343-355) and as modified June 20, 1946, concludes the District Court from making an order denying confirmation and orders subsequent thereto, petitioners respectfully pray for the issuance of a writ of certiorari directed to said United States Circuit Court of Appeals to send to this Court for review and determination, its said order and decrees of May 23, 1946 as modified June 20, 1946 (R. 343-355).

Statement

The Convertible Gold bonds constitute an issue of $32,228,000 of bonds authorized and approved for sale to the public on May 1, 1930 by the Interstate Commerce Commission (hereinafter called "ICC" or "Commission").

The bonds were accordingly sold to the public after The Chase National Bank of the City of New York (hereinafter referred to as the "Chase Bank") was appointed Trustee for the Convertible bondholders. (Pertinent provisions of the trust Indenture dated May 1, 1930 between the Debtor and the Chase Bank as Trustee is found in the Appendix to Add. R. pp. 1-16.)

In April 1932, the same Chase Bank, heading a group of four other banks, obtained from the Debtor, $15,589,000 in First Mortgage bonds, as collateral for a loan of $8,250,000.

The Chase Bank Group attempted to foreclose its lien on this collateral, but were enjoined from so doing. (See *Chase Nat'l. Bank* v. *Chicago, R. I. & P. R. Co.*, 294 U. S. 648.)

By orders of the District Court made on September 7, 1943 over the opposition of petitioners (District Court Record, p. 4325—Order No. 15B) and successively on September 24, 1943 (District Court Record, p. 4341—Order No. 15C), October 4, 1943 (District Court Record, p. 4347—Order No. 15D) and on October 7, 1943 (District Court Record, p. 4353—Order No. 15E), the injunctive order of said District Court (District Court Record, p. 281—Order No. 15A) as affirmed by this Court in 294 U. S. 648 was revoked and the Chase Bank Group was allowed to sell the collateral held by them.

The Debtor's estate and hence the junior creditors thereby suffered a loss amounting to $13,631,745.15 (Annual Report of Debtor for year 1943. See Appendix to Add. R. 49.).

The foreclosure of the collateral by the Chase Bank Group heretofore enjoined by this Court is directly related to the merits of the plan of reorganization which is the question before this Court, since it reduces the share of the trust estate available to the Convertible Bondholders.

Petitioners' petition to the District Court in 1940, in October 1941, May 1942 and June 1944, on a hearing of these related objections to the plan of reorganization would not be heard by the Court. The objections relating to the Bank loans were ordered stricken out at the outset of the District Court hearing held on October 13, 1941 (Add. R. Appendix, p. 50).

The United States Circuit Court of Appeals similarly held (R. 354) that "a consideration of the cogency of such an argument is not related to the merits of the plan of reorganization", and refused to grant petitioners a hearing thereon.

Petitioners respectfully submit that the rulings of the Courts below were erroneous; that petitioners are entitled to a hearing and determination on the merits of the effect of the Chase Bank Group collateral loans and foreclosure thereof on the treatment accorded to the Convertible Bondholders Group and a determination as to whether the plan should provide more equitable treatment for said bonds as against the Chase Bank Group.

The second aspect of this petition concerns the specific manner in which the claims of the Convertible bondholders were dealt with.

Under the 1940 plan of the ICC (i.e. the plan of October 31, 1940 promulgated and urged by the first and refunding mortgage committee R. 31-161; 247 ICC 533) the Convertible bond issue with a claim of $44,796,920 were allocated 139,654.67 shares of new common stock out of a total proposed issue of 1,512,424.34 shares (See 247 ICC 533) or 4.33 shares of common stock per $1000 of creditor claims

being, in the aggregate, less than 10% of the total common stock proposed to be issued.

After other objections to the 1940 plan were filed and heard before the District Court the plan was remanded to the ICC.

Minor changes were made to the plan by the ICC. In addition, it distributed $38,011,922 in cash to the security holders. The respondents received 99% of the cash and the petitioners received only 1%. Petitioners claim this disposition to be arbitrary and unfair.

Thereupon, the District Court materially altered the plan. It substituted its judgment for that of the Commission and decided "to leave the C. & M. bonds (Choctaw & Memphis) undisturbed, not affected by the plan in any way" (R. 312-313, par. 8). See Petition in this Court, Oct. Term 1946, No. 454.

By thus altering the terms of the plan without ICC approval, the District Court deprived the uncompensated Convertible Bondholders and other unsatisfied junior creditors of the sum of $264,300, which sum is allocated to the C. & M. bondholders.

This material change in the ICC plan made by the Court overcompensated said creditors, not only by the cash, but its improved standing in a reorganized recapitalized company. This change the Court was not authorized to make. The matter was for the Commission to determine (R. 295).

The net effect of the District Court's changes and approval of the respondents' 1940 plan is to give them in addition to the 100% satisfaction of their claims (considering improved securities and curtailed capitalization, etc.), $50,420,522 in cash and new mortgage securities (being the $38,011,922 cash above referred to plus $12,409,600 in first mortgage bonds) plus 90% control of the new authorized common stock of the new company which now includes an

additional $72,000,000 in cash, plus R. F. C. collateral of $41,688,838 in the company treasury.

Since the inception of the plan the assets of the debtor have increased by the sum of $185,241,485. In addition, its annual fixed charges under the proposed plan have decreased by the sum of $625,973. No full consideration of the basic elements of the plan has been had by the Commission since these changes have taken place.

The Convertible Bondholders, therefore, receive no benefit either in new securities or change of status from the improved conditions, and are thus being unjustly deprived of property without due process of law.

The United States District Court for the Northern District of Illinois, Eastern Division, by its order of June 15th, 1945 (R. 309-316) modified (as to the treatment of C. & M. Bonds) and approved the plan. The United States Circuit Court of Appeals for the Seventh Circuit, by its order and decree entered May 23rd, 1946 (R. 355) and as modified June 20th, 1946, affirmed said order of the District Court (Add. R. 93-112).

The Circuit Court, in its opinion, stated, "In so arguing, it seems to us that the debtor overlooks the point that any determination of total capitalization by the Commission is in itself a valuation, which, concededly, is not subject to review" (Add. R. 99).

Although the petitioners brought to the attention of both the District Court and the Circuit Court the fact that the ICC had previously ruled that the return of R. F. C. collateral "would necessitate material modification of the plan", both courts refused to enable the ICC to do so since the return of said collateral.

The District Court has since denied confirmation to the approved plan and said Court and the Interstate Commerce Commission are considering revisions and new proposals, one of which was recently (Nov. 22, 1946) approved by the District Court.

Questions Presented

The review requested herein raises questions of the greatest public and legal importance.

Were petitioners properly denied a hearing on their objection to the plan to the effect that the Chase National Bank, as trustee for the issue of Convertible bonds and the holder of collateral for loans privately extended to the debtor in imminent insolvency, was in the exercise of a dual and conflicting role and that in the exercise of this dual role, the bank violated its position as fiduciary to the Convertible bondholders by retaining or foreclosing collateral belonging to the Debtor?

Certain classes of senior creditors, being fully compensated, and the RFC loans having been paid off pursuant to order of the District Court, November 8, 1944 and collateral amounting to $41,688,838 having been returned to the Debtor estate, is the certified plan of reorganization nevertheless to be approved as fair and equitable when the Interstate Commerce Commission has declared that such payment of RFC loans and return of RFC collateral "would necessitate material modification of the plan" (R. 234)?

Is this plan of reorganization fair and equitable?

Is the action of the District Court in substituting its judgment for that of the Commission and deciding "to leave the C. & M. bonds undisturbed, not affected by the plan in any way" in accordance with Section 77 of the Bankruptcy Act (R. 306)?

Is the affirmance by the U. S. Circuit Court of Appeals of the District Court's approval of the plan proper and should it be permitted to stand in view of its expressed belief that it did not have the authority to reverse the decision of the District Court, which belief is clearly erroneous?

Should the effects of wartime and post-war earnings be considered by the ICC and by the courts in judging the present fairness of the plan?

Reasons Relied on for the Allowance of the Writ

This honorable Court should determine the questions presented by the petitioners since fundamental public policy is involved.

The petitioners should have an opportunity to be heard concerning their objections to the plan in the light of the dual relationship of the Trustee of the Convertible Bonds.

Consideration should be had of the necessity of remanding the plan to the ICC for review after the return of the RFC collateral as per the ruling to that effect by the ICC.

The right of the District Court to modify the plan materially without receiving the prior approval of the ICC should be reviewed.

The authority of the Circuit Court to review obsolete valuations of the ICC in the light of substantial improvements accruing since the inception of the plan should be defined by this Court.

The law should be clarified by a ruling of this court that a plan may be denied approval by any court if it has, through obsolescence, become unfair to any class of creditors.

Conclusion

The Convertible Bondholders Group respectfully submits that the decision of the U. S. Circuit Court of Appeals for the Seventh Circuit is erroneous, that the questions involved are constitutional questions and are of general public importance, and that it is in the public interest to have those questions answered as soon as practicable by an authoritative decision of this Court.

WHEREFORE, the petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this honorable Court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, directing that Court to certify and send to this Court for its review and determination on a day certain to be named therein, a transcript of the record and proceedings herein; that the decree of said Court be reviewed insofar as the method and treatment of the Convertible Bondholders' and junior creditors' claims generally are concerned and insofar as it approves the plan of reorganization, to the end that the judgment herein of said Circuit Court of Appeals be reversed; and that your petitioners may have such other and further relief in the premises as to this Court may seem just and proper.

Dated, New York, N. Y., December 13, 1946.

HARRY KIRSHBAUM,
MICHAEL GESAS,
Counsel for Petitioners.

IN THE

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OCTOBER TERM, 1946.

No. .....

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IN THE MATTER

of

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Debtor.

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Petitioners,

v.

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Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 343-355) is reported in 157 F. (2d) 241. The opinion of the District Court (R. 301-308) has

not been reported. Directly related to the approved plan of reorganization in this proceeding and hence to this petition for writ of certiorari is the opinion and decision of the said Circuit Court in the *Choctaw & Memphis* case (No. 454, petition for writ of certiorari, October Term, 1946) reversing the opinion of the District Court. This companion opinion is reported in 155 F. (2d) 889. The opinion of the District Court is not reported but will be found in Cause No. 454 before this Court for the October 1946 Term under the title "Joseph B. Fleming and Aaron Colnon, Trustees, etc., Petitioners versus John C. Traphagen, James E. Gowen, et al., etc., Respondents."

Jurisdiction

On June 20, 1946, the United States Circuit Court of Appeals for the Seventh Circuit entered an order affirming the interlocutory order of the District Court approving the plan of reorganization for the Debtor.

Thereafter, and on June 28, 1946, the District Court having jurisdiction denied confirmation to said approved plan and referred the case back to the Interstate Commerce Commission for modification and for the consideration of new plans.

On July 18, 1946, the Interstate Commerce Commission made an order reopening the case for public hearing for the modification of the present plan and the consideration of new plans of reorganization for the Debtor. Appeals from the order of the District Court of June 28, 1946 denying confirmation have been filed by several parties in the United States Circuit Court of Appeals, Seventh Circuit from July 26 to August 7, 1946.

In order to avoid multiplicity of and confusing litigation, petitioners herein made application to the said Circuit Court for rehearing and reargument of the order of affirmance and for modification or recall of its inter-

locutory opinion and order of June 20, 1946, setting forth the subsequent opinions and orders of the District Court denying confirmation of the plan and of the Interstate Commerce Commission reopening the case and assigning the same for public hearing.

On September 18, 1946, the Circuit Court entered an order on said application denying petitioners' motion for reargument and recall of its opinion but granting a stay of mandate until the disposition by this Court of petitions for writ of certiorari (See Additional Transcript of Record pp. 114-149).

Jurisdiction is, therefore, lodged in this Court to hear and determine this petition for writ of certiorari and the appeal from the original judgment entered in the Circuit Court.

Gypsy Oil Co. v. *Escoe,* 275 U. S. 498;
Pfister v. *Northern Illinois Finance Corp'n.,* 317 U. S. 144 at page 149;
Market Street R'y. v. *Railroad Commission of California,* 324 U. S. 548.

Petitioners have kept this honorable Court advised of current applications in this proceeding brought by petitioners before the United States Circuit of Appeals, the granting of which would obviate recourse to this honorable Court. The motion brought before the Circuit Court for rehearing and recall of its opinion was as this Court is aware, based on substance and was not merely for the purpose of extending time to bring this petition for certiorari.

Hence the time for appeal to this honorable Court has not expired.

Leishman v. *Associated Electric Co.,* 318 U. S. 203, 205-6;
Pfister v. *Northern Illinois Finance Corp'n.* (*supra*), 317 U. S. 144;

Zimmern v. *U. S.*, 298 U. S. 167;
Section 8(a) of the Act of February 13, 1925 to amend the Judicial Code, Chap. 229, 43 Stat. 936.

The time for filing a petition for writ of certiorari is computed from the date of entry of the order of the Circuit Court dated September 18, 1946, staying the issuance of the mandate until disposition of this petition on the merits.

Commissioner of Int. Revenue v. *Bedford's Estate*, 325 U. S. 283, 285, 286.

A statement of the constitutional, statutory and other grounds on which the jurisdiction of this Court is invoked is given in the petition (pp. 3-4) and to avoid duplication, is not repeated here.

Statement of Case

A statement of the case is set forth in the petition under the headings "Introductory Statement of Matter Involved" and "Statement" and to avoid duplication, is not repeated.

Specification of Errors

The Circuit Court of Appeals erred:

1. In ruling that the Chase National Bank, in the dual and conflicting role of trustee for the Convertible bonds and as holder of collateral for loans privately extended to the Debtor without knowledge or consent of the Convertible Bondholders was not violating its position as fiduciary and not prejudicial to the Convertible Bondholders and the treatment accorded to them in the plan of reorganization approved by the Court.

2. In ruling that the District Court properly refused to hear pertinent objections to the plan of reorganization duly filed by petitioners and in denying petitioners a hearing on related objections to the plan. (Add. R. Appendix p. 50).

3. In holding that the plan of reorganization is fair and equitable and compatible with the public interest and that it complies with the requirements of subsections (b) and (e) of Section 77 of the Bankruptcy Act, as amended.

4. In holding that the plan of reorganization affords due recognition to the rights of the Convertible Bondholders and that the same does not discriminate unfairly in favor of holders of preferred securities.

5. In holding that the R.F.C. collateral returned to the trust estate should remain undistributed, despite the ruling of the Interstate Commerce Commission that the payment of the R.F.C. claims "would necessitate material modification in the plan" (257 ICC 265, 272), and despite the fact that the Convertible Bondholders are virtually excluded from participation in the plan of reorganization.

6. In approving as a valid post-war plan an outmoded reorganization for the debtor, a plan in fact, formulated and adopted prior to the commencement of the war (1937-1940) and based on depressed earnings, etc. of that period.

7. In approving as valid, a plan of reorganization for the debtor which was altered in several material respects by the District Court without resubmission to or re-examination by the Interstate Commerce Commission.

8. In incorrectly denying to itself the authority to review the obsolete valuations of the ICC in the light of substantial improvements in the financial condition of the Debtor.

9. In approving the distribution of $12,409,600 in new first mortgage bonds and $38,011,922 in cash to the senior creditors on an arbitrary basis in direct variance with the provisions of the approved plan and without regard to proper legal and equitable standards.

10. In denying petitioners' application for reconsideration, reargument and recall of its opinion and order of May 23, 1946 and June 20 1946 since the District Court in the due exercise of its judicial powers given pursuant to Sec. 77 of the Bankruptcy Act, as amended, properly refused to confirm the plan of reorganization for the Debtor and referred the case to the Interstate Commerce Commission for re-examination to afford the parties their day in Court and said Interstate Commerce Commission has ordered the case re-opened and assigned for public hearing for modification of or the consideration of new plans of reorganization.

11. Upon such other errors as may appear to this Court not assigned or specified herein.

Summary of Argument

In the interest of directness and conciseness, petitioners set forth briefly, the propositions of law relied on to support the foregoing petition (Rules 27 and 38 of Rules of Supreme Court of United States).

I.

The plan of reorganization approved countenances illegal preference treatment given to the Chase Bank Group for first mortgage collateral privately obtained from the Debtor without consent of the Convertible Bondholders by allocating to them 262% of the amount of their claim in new choice securities at the direct expense of the Con-

vertible Bondholders who remain virtually excluded from participation in the plan of reorganization.

Said plan which thus rewards such conduct of a trustee for bondholders by permitting it to retain or foreclose said collateral in lieu of payment as was done with the R.F.C. loans, or other equitable treatment of its claim is a fraud upon the bondholders the *cestuis que trusts* and is unjust, unfair, inequitable and incompatible with the public interest.

> Section 60 of the Bankruptcy Act, as amended;
> *Buffum* v. *Barceloux Co.*, 289 U. S. 227 at page 236.

The Chase Bank Group should be held to account as a trustee *ex maleficio* for its conduct and the value of the collateral which it improperly acquired and then retained or conveyed to others.

> *Buffum* v. *Barceloux Co.*, 289 U. S. 227, 236;
> *U. S.* v. *Dunn*, 268 U. S. 121;
> *Jackson* v. *Smith*, 254 U. S. 586, 588;
> *Magruder* v. *Drury*, 235 U. S. 106;
> *Meinhard* v. *Salmon*, 249 N. Y. 458, 164 N. E. 545, per Cardozo, J.

A plan of reorganization which approves, accepts and recognizes this wrongful discrimination against the Convertible Bondholders is invalid.

II.

The District Court and Circuit Court denial to petitioners of a hearing on objections under Section 77 of the Bankruptcy Act, as amended, relating to the Chase Bank Group's unlawful possession of the Debtor's collateral and the preference treatment accorded said Group under

the approved plan of reorganization which directly and adversely affected the Convertible Bondholders' interests and allocation of securities thereunder, was unconstitutional and a deprivation of their property without just compensation.

Fifth Amendment to the Constitution of the United States;
In re Central R. Co. of New Jersey (C.C.A. 1943) 136 F. (2d) 633, certiorari denied 320 U. S. 805;
Fierman v. *Seward Nat'l. Bank of N. Y.*, 61 F. (2d) 952, certiorari denied 288 U. S. 613;
In re Times Square Auto Supply Co., 47 F. (2d) 240 reversing 43 F. (2d) 661, certiorari denied 283 U. S. 856.

III.

The District Court did not have the right to modify the plan without the prior approval of the Commission. Section 77(d) of the Bankruptcy Act provides, in part:

> "No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court."

Section 77(e) defines the rights and prerogatives of the Court after certification to it of a plan by the Commission. That section gives the court the right to approve the plan, disapprove and dismiss the proceedings, or disapprove and refer the proceedings back to the Commission for further action. Nowhere is the court given the right to modify the plan.

It is respectfully submitted that the plan *as it now exists* has not been approved by the Commission nor certified by it to the court. The last report of the Commission is dated May 1, 1944. On November 8, 1944 the court

ordered the claim of the R. F. C. paid. As a result thereof collateral securities valued at $40,310,722 were returned to the debtor. On June 15, 1945, the court ordered that the Choctaw & Memphis Bonds shall remain undisturbed in the reorganization. (See Exhibit A to the plan.)

Not only must the Commission pass upon these modifications of the plan under the above quoted portion of Section 77(d), but it should have an opportunity to appraise the effect of these changes upon the remainder of the plan.

This is particularly true in the light of the Commission's express statement that payment of the R. F. C. loan "would necessitate material modification of the plan" (R. 234).

The Circuit Court itself recognized the correctness of this principle, despite the fact that it did not act in accordance therewith. The court said, in its opinion (R. 345):

> "The Court must approve or disapprove the plan in its entirety. It alone cannot correct the plan but it may suggest improvements to the Commission."

To the same effect is *Ecker* v. *Western Pacific Railway Co.*, 318 U. S. 448, wherein the Supreme Court said, at page 474:

> "Thus limited the district court acts concerning the plans only upon the issues specifically delegated by sub-section (e). As to these, its powers are negative. It may veto the plan in its entirety but may improve it only by suggestion."

The Circuit Court's affirmance of the modification of the plan by the District Court was reversible error.

IV.

The Circuit Court has the right to review the plan in the light of improvements subsequent to the inception of the plan. Its failure to recognize its authority so to do constitutes reversible error.

Petitioners concede that they cannot in this appeal attack the validity of the Commission's valuation as of the time of its deliberations concerning such valuations. No such attack is here made. Petitioners further concede that abnormal wartime earnings should not properly be used as a guide to future earnings.

The petitioners do insist, however, that the authority of the courts, both the District Court and the Circuit Court, extends to:

1. A review of the *method* of evaluation adopted by the Commission; and

2. A review of the *effect* of wartime income, actually earned, upon the capital structure of the debtor.

These two points may be considered in order.

1. *The method of valuation.*

By its October 31, 1940 report the Commission valued the property of the debtor at $351,000,000 (R. 142). By its July 31, 1941 report the Commission increased its valuation to $368,127,410 (R. 168). The petitioners accept as valid for purposes of this petition these two valuations as of the date of the respective reports.

However, in the report dated January 3, 1944, the Commission reduced the valuation to $356,117,327 (R. 245). The reason for the reduction is given in the report of May 1, 1944 (R. 250). The report reads:

> "From the foregoing it is clear that the decrease of $12,010,083 is the net result from the reduction of

> $13,034,916 in the equipment obligations during the period January 1, 1942, the former effective date of the plan, to January 1, 1944, the new effective date of the plan and the increase of $1,024,833 in the new common stock provided for in the plan. There is no decrease in the amount of the various other classes of securities comprising the total capitalization. As in other reorganization proceedings, the plan in this proceeding contemplates leaving equipment obligations of the debtor undisturbed. The capitalization of $356,117,327, includes equipment obligations outstanding as of January 1, 1942. While the reduction in the amount of equipment obligations reduced somewhat the fixed annual cash requirements of the reorganized company, this fact was recognized by us in the approval of an increase of $1,024,833 in the amount of Common Stock provided for in the supplemental report of January 3, 1944. We also recognize that the amount of equipment obligations of a railroad is subject to fluctuation upward as well as downward, and in our opinion, we would not be warranted in increasing the amounts of the various other classes of securities comprising the approved capitalization to any greater extent than was done."

Hence it may be seen that the reduction in valuation of the debtor's property was made on the basis of a *reduction* in outstanding equipment obligations. It is obvious that the reduction in outstanding obligations actually reflects an *increase* in the value of the debtor's property. A decrease in valuation was clearly unwarranted.

This Court, in *Ecker* v. *Western Pacific Railway Corp.*, 318 U. S. 448, said, at page 474:

> "While by the terms of the statute the valuation of the property is left to the Commission, without participation by the Court, this valuation must be made

in accordance with the direction of the statute and as to that valuation is subject to judicial review."

It is submitted that the court's authority to review the method of valuation extends to a review of the method of re-valuation, and that re-valuation downward based upon a decrease in corporate liabilities is error in method sufficient to warrant rejection by the court.

2. *The effect of wartime earnings.*

In *Institutional Investors* v. *Chicago, Milwaukee, St. Paul and Pacific Railway Co.*, 318 U. S. 523, this Court said, at page 543:

> "We cannot assume that the figures of war earnings could serve as a reliable criterion for that 'indefinite future'. As some of the bondholders point out, the bulge of war earnings per se is unreliable for use as a norm unless history is to be ignored; and numerous other considerations, present here as in former periods, make them suspect as a standard for any reasonably likely future normal year."

The petitioners do not urge such use of wartime earnings. However, it cannot be denied that huge wartime profits were earned. These earnings went into the assets of the debtor. With these earnings debts were paid, improvements were made, cash reserves were built up, and there was a general strengthening of the financial condition of the debtor. The extent of the changes made possible by these wartime earnings will be later discussed.

No authoritative decision has yet been made as to whether such changes, actually accomplished since the last properly considered valuation by the Commission, may be the basis for the refusal of the courts to approve a plan. The expressed belief of the Circuit Court that it could not now review the Commission's valuations, made obsolete by the *effects* of wartime earnings was reversible error.

V.

The effects of wartime earnings on the capital structure of the debtor were sufficiently substantial to warrant the rejection of the plan. Two factors affect the starting point of a consideration of this point. First, it should be remembered that the *last* properly considered valuation by the Commission was reflected in its report of July 31, 1941. Second, the District Court, in its opinion rendered upon its refusal to confirm the plan, stated:

> "In the present case we have a plan that except for slight modifications was prepared by the Commission in 1940 and rests on earnings, etc., going back to 1937 and even beyond." (Add. R. 138.)

The facts that evidence the effects of the wartime earnings are as follows:

That the Trustees for the debtor estate made total net capital expenditures from Jan. 1, 1940 to Apr. 30, 1946 of	$37,246,965.49
That the total net decrease in outstanding debt from Apr. 30, 1940 to Apr. 30, 1946 amounted to	$25,411,598.97
That the total amount of cash or cash equivalents in the hands of the debtor as of Apr. 1, 1946 is	82,272,199.08
That R. F. C. collateral returned to the debtor is valued at	40,310,722.02
That the total, actual increase in value of the debtor's property in Apr. 1946 over Jan. 1940 amounts to	$185,241,485.56.

These facts are not a part of the record in the proceeding before the District Court for approval of the plan. However, they are official records of the debtor, prepared by the auditor of the debtor, and were introduced in evidence before the District Court in the proceeding for confirmation. (See record on appeal to Circuit Court of those proceedings.)

In addition to the above factors which constitute direct items of increased value of the debtor estate, a substantial reduction in fixed annual charges of the company has been effected since the inception of the plan. These reductions resulted from changes in the plan made since the last consideration of the plan by the Commission. They are broken down as follows:

R.F.C. Securities:	Amount	Int. Rate	Fixed Charges eliminated
Collateral note	$2,500,000.	2½%-1½%	$ 62,500.00
First Mtg. Bonds ..	4,070,874.	4%	162,834.96
Gen'l Mtg. Bonds..	5,992,850.	4%	259,678.25
Choctaw & Memphis Securities:			
New C. & M. Bonds	$3,524,000.	4%	$140,960.00
Total annual reduction of fixed charges: ...			*$625,973.21*

The record shows that the amount of fixed interest charges was basic in the composition of the plan. The Commission stated:

> "It is our opinion that, in order to provide a margin for minimum additions and betterments, the fixed-interest charges of the reorganized company should not exceed $2,400,000" (R. 142).

A comparison between the maximum amount of fixed interest charges permitted under the plan and the amount of fixed interest charges reduced since the inception of the plan clearly indicates a need for complete revision of the plan.

VI.

Substantial justice would result from a reversal of the decision of the Circuit Court, and a remanding of the plan to the Commission for further consideration.

After approval of the plan, it was submitted to the security holders for their approval. Two classes of security holders rejected the plan by overwhelming majorities. Thereupon the plan was submitted to the District Court for confirmation. The District Court refused to confirm the plan, and, by order dated July 22, 1946, referred the plan back to the Commission for reconsideration. (Add. R. 140-142.) Appeals to the Circuit Court from this order are now pending.

The Court found that the plan does not make adequate provision for fair and equitable treatment of the Convertible Bondholders, and that it does not conform to the requirements of subsection (e) of section 77 of the Bankruptcy Act.

If the plan is unfair, and does not conform to the requirements of the act, it should not be put into effect. Whether the remanding should occur upon proceedings to approve or upon proceedings to confirm properly depends upon whether the changed conditions making such remanding proper occurred between inception of the plan and the proceedings to approve, or between approval of the plan and proceedings to confirm. (*R. F. C.* v. *Denver & R. G. W. R. Co.*, 66 Sup. Ct. 1282.)

However, whether the remanding occurs in one proceeding or the other, the result is the same. The plan will be reconsidered by the Commission and, presumably, a fair and equitable plan will result from its new deliberations. A reversal of the decision herein appealed from will eliminate further time and money consuming litigation in connection with the proceedings to confirm.

It is not the intention of the petitioners to suggest to this honorable Court that the confirmation proceedings are in any way binding in the proceedings to approve, nor that a short cut be taken even in the interests of justice. This last point would never have been written were it not for the sincere belief that the remainder of the brief includes cogent, legal justification for a reversal; and the added consideration that the difficulty of determining exactly when the changed conditions occurred should not, in justice, react to the detriment of the petitioners.

Conclusion

Petitioners respectfully submit that the decision of the Circuit Court of Appeals for the Seventh Circuit is erroneous; that the questions involved are constitutional questions and are of general importance in the administration of the Bankruptcy Act and that it is in the public interest to have the order of the said Circuit Court reviewed and determined by this Court and that the order and mandate of the Circuit Court be stayed meantime until the final hearing and determination by the Interstate Commerce Commission and the Courts below of a new or revised *confirmed* plan of reorganization for the Debtor.

Dated, December 13, 1946.

Respectfully submitted,

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MICHAEL GESAS,
Counsel for Petitioners.

HARRY KIRSHBAUM, Esq.,
JOHN E. STONE, Esq.,
of Counsel.

APPENDIX "A"

FIFTH AMENDMENT

TO THE

CONSTITUTION OF THE UNITED STATES.

No person shall be held to answer for a capital, or otherwise infamous crime unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be *deprived of life, liberty, or property, without due process of law;* nor shall private property be taken for public use, without just compensation. (Emphasis ours.)

APPENDIX "B"

The Bankruptcy Act, as amended:

Sec. 24(c). The Supreme Court of the United States is hereby vested with jurdisdiction to review judgments, decrees, and orders of the Circuit Court of Appeals of the United States and the United States Circuit Court of Appeals for the District of Columbia in proceedings under this title in accordance with the provisions of the laws of the United States now in force or such as may hereafter be enacted. (11 U.S.C.A. section 47(c).)

Sec. 77(b). A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stock-

holders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise; (3) may include, for the purpose of preserving such interests of creditors and stockholders as are now otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings, experience, and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; (5) shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations, the retention of all or any part of the property by the debtor, the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens, indentures, or other similar interests, the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, or in satisfaction of claims or rights or for other appropriate purposes; and may deal with all or any part of the property of the debtor; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section. (11 U.S.C.A. section 205(b).)

Sec. 77(d). The debtor, after a petition is filed as provided in subsection (a) of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, or if heretofore approved, then within six months of August 27, 1935, and not thereafter unless such time is extended by the judge from time to time for cause shown, no single extension at any one time to be for more than six months. Such plan shall also be filed with the Commission at the same time. Such plans may likewise be filed at any time before, or with the consent of the Commission during, the hearings hereinafter provided for, by the trustee or trustees, or by or on behalf of the creditors being not less than 10 per centum in amount of any class of creditors, or by or on behalf of any class of stockholders being not less than 10 per centum in amount of any such class, or with the consent of the Commission by any party in interest. After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be comparable with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall

thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court. (11 U.S.C.A. section 205(d).)

Sec. 77(e). Upon the certification of a plan by the Commission to the court, the court shall give notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made under or to be

made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

* * * * *

If it shall be necessary to determine the value of any property under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts. (11 U.S.C.A. section 205(e).)

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Supreme Court of the United States

OCTOBER TERM, 1946

No. 791

IN THE MATTER

of

THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,

Debtor.

GERALD AXELROD, *et al.*, constituting a Group of Individual Owners of the 4½% Convertible Gold Bonds of the above-named Debtor,

Petitioners,

v.

JOSEPH B. FLEMING and AARON COLNON, as Trustees of The Chicago, Rock Island and Pacific Railway Company, *et al.*,

Respondents.

REPLY OF PETITIONERS TO BRIEF OF METROPOLITAN LIFE INSURANCE COMPANY, *ET AL.* RESPONDENTS.

January 27, 1947

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INDEX

PAGE

Introductory Matter 1

ARGUMENT:

1. The petition is timely 3
2. The denial of a hearing on objections to the plan of reorganization is a live issue 4
3. The questions presented constitute valid grounds for the granting of a writ of certiorari 5

Conclusion 11

TABLE OF CASES

Bitker v. Hotel Duluth Co., 83 F. (2d) 721 (C. C. A., 8th Cir., 1936), aff'd 299 U. S. 577 ..... 2, 3

Blumgart v. St. Louis-San Francisco R'y Co., 94 F. (2d) 712 2

Continental Ill. Nat. Bank v. Chi., Rock Island & P. R'y Co., 294 U. S. 648 ..... 4, 9

Ecker v. Western Pac. R'y Co., 318 U. S. 448 8

Gardner v. State of New Jersey, U. S. Sup. Ct. Bulletin, Vol. 7, 613, 622 4

Gypy Oil Company v. Escoe, 275 U. S. 498 3

STATUTES

Bankruptcy Act, Sec. 77(d) 8

Bankruptcy Act, Sec. 77(e) 6

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THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,

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Respondents.

REPLY OF PETITIONERS TO BRIEF OF METROPOLITAN LIFE INSURANCE COMPANY, *ET AL.* RESPONDENTS.

Introductory Matter

This reply brief is submitted pursuant to permission granted on January 13, 1947.

1. Respondents hasten to point out, in fact at the very opening of their brief (page 2 thereof) that the petitioners

are small investors as compared to some of the interests represented in these proceedings. Petitioners admit that they are small investors, yet nevertheless claim that they are entitled to equal protection of the laws. However, the respondents omit to state that while there is unanimity among the 4½% Convertible Bondholders who rejected the approved plan for reorganization of the Debtor as unfair and inequitable to them, First and Refunding Mortgage Bondholders to the extent of $19,500,000 personally appeared before the District Court on November 1, 1946 and orally voiced their opposition to the present approved plan of reorganization (p. 224 of minutes of that hearing). These bond holdings are at least several times in excess of the amount of bonds held by the respondent Metropolitan Life Insurance Company, the sponsor and proponent of the present plan.

2. In a footnote to the opening paragraph of their brief, Respondents allege that the interests of the Convertible Bondholders were actively and vigorously represented by the Chase National Bank as trustee under the indenture under which the bonds were issued. But the indenture trustee, as such, does not in these proceedings, *ipso facto,* represent the bondholders but rather its own interests as trustee. This trustee could not and did not vote to reject the present plan. The plan was rejected by the bondholders themselves.

Blumgart v. *St. Louis-San Franciso R'y. Co.,* 94 F. (2d) 712, 716 (C. C. A. 8th, 1938);

Bitker v. *Hotel Duluth Co.,* 83 F. (2d) 721, 723 (C. C. A. 8th, 1936) aff'd 299 U. S. 577.

Further, it should be remembered that this proceeding is essentially a contest between the secured bondholders and the Convertible Bondholders. Since up to the time it was permitted to foreclose its collateral, the Chase National Bank was substantially financially interested in the secured

issues, the vigorousness of its representation of the Convertible Bondholders throughout the period of formulating the plan may be looked upon with some suspicion.

"The trustee's judgment must not be substituted for that of the real creditors who are to be safeguarded in passing upon the question of whether a plan is fair and equitable." *Bitker* v. *Hotel Duluth* (*supra*), 83 F. (2d) 721 at p. 723.

3. In the footnote to page 3 of the Respondents' brief, mention is made of the petition for reconsideration by this Court in *Fleming* v. *Traphagen.* On January 13th, 1947, this Court announced its denial of that petition.

ARGUMENT

1. The petition is timely.

The Petitioners concur with Respondents that the governing principles of law are contained in the portion of the opinion in *Gypsy Oil Company* v. *Escoe,* 275 U. S. 498, quoted on page 6 of Respondents' brief.

The controlling factor is, of course, whether or not Petitioners' petition for rehearing was actually entertained by the Circuit Court. It is the Petitioners' view that their petition was so entertained.

This is based upon two grounds:

A. The petition for rehearing to the Circuit Court was *denied,* and not dismissed. A refusal to consider would have resulted in a dismissal. A denial presupposes a determination on the merits.

B. The Circuit Court stayed its mandates "until the disposition of the petitions for writ of certiorari in the Supreme Court of the United States". Hence, irrespective of the wording of the remainder of the Circuit Court's order, it is very evident that the

Circuit Court intended that its order be in form to permit review by this Court. Any other interpretation would render meaningless the second portion of the order of the Circuit Court.

2. The denial of a hearing on objections to the plan of reorganization is a live issue.

The question of the method of payment of the class of creditors known as the Chase Bank Group is interwoven into the very fabric of the reorganization. Payment of or settlement with one class of creditors must necessarily affect the rights of all other classes less adequately secured. The securities allotted to the Convertible Bondholders under the plan (*i. e.*, 4 shares of common stock for each $1,000 bond) have become diluted by reason of the illegal conduct of the Chase Bank Group, in that additional First Mortgage Bonds are now outstanding (see our Main Brief, p. 6; see also Respondents' Brief, p. 16, Table footnote A).

The judicial approval of the plan is, subject to variance on confirmation, intended to adjudicate the rights of the classes of creditors. Hence, the claim of the Convertible Bondholders, as a class, against the Chase Bank Group, as a class, was properly before the court upon the approval proceedings. For that reason it was not necessary for the Petitioners to prosecute the appeals mentioned on pages 10 and 13 of the Respondents' Brief. This Court has said that the securities of the debtor are the subject of this reorganization. *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & P. R'y Co.*, 294 U. S. 648 (1935). And in *Gardner* v. *State of New Jersey*, U. S. Sup. Ct. Bulletin, Vol. 7, 613, decided January 20, 1947, it was held that the property of the debtor was in the custody of the court, irrespective of where the property may be located, and that the reorganization court has full jurisdiction over all questions respecting the title to such property.

Petitioners are not required to bring a petition for certiorari upon the entry of every intermediate order. Such interlocutory orders are, however, reviewable in the final order disposing of the litigation.

The claims of the Convertible Bondholders against the Chase Bank are, therefore, directly related to any fair and equitable plan of reorganization.

Page 12 of the Respondents' brief mentions an "*agreed* order" striking out in advance of a hearing thereon, certain of the Petitioners' allegations from their objections. Lest the term "agreed order" be misconstrued, Petitioners beg to point out that it was the *form,* not the substance, of the order that was agreed to. The order, as to the *form* of deletions to be made, was subject to a direction by the District Court to strike out those allegations. The direction of the District Court was not by consent of the Petitioners.

3. The questions presented constitute valid grounds for the granting of a writ of certiorari.

A. The Petitioners are accused of ignoring the allocation of $38,000,000 in cash to some of the creditors in their discussion of the method of re-capitalization. The Petitioners did not ignore this allocation, but merely recognized that the sum was not distributed as a bonus. It was accompanied by an equivalent reduction of claims against the debtor.

Surely, that does not mean that the net asset value of the estate has decreased by reason of said payment. Rather, it is definite proof that the higher earning potential of the debtor renders the railroad more valuable by reason of its demonstrated ability to pay off $38,000,000 on funded debt.

B. There is nothing in any of the cases cited on page 15 of the Respondents' brief which prevents a rejection of a valuation by the I.C.C. based upon an improper method of

valuation. On the contrary, these cases state that the method of evaluation, being a question of law, is subject to judicial review. Particularly is this so where the result is unfair and inequitable on its face.

Sec. 77(e) last paragraph of the Bankruptcy Act, as amended, specifies the method of valuation which I.C.C. must use.

C. The discussion, on page 15 of the Respondents' brief, concerning the issuance of $11,000,000 of new bonds and the use made of those bonds constitutes a completely fallacious argument on the question of valuation. The issuance of $11,000,000 of bonds and the receipt therefor of $11,000,000 in cash in the original plan would have added $11,000,000 to each side of the balance sheet and would not, therefore, affect the valuation of the debtor's property. The present changed plan provides for the issuance of $11,000,000 in bonds and the distribution of them to outstanding creditors, resulting in the reduction of claims in an equivalent amount. It was merely the substitution of one type of indebtedness for another. Thus it, too, had no effect on the value of the debtor's property. Therefore, it cannot be said that the change of plan constituted the slightest warrant for a decrease of valuation from $368,000,000 to $356,000,000.

D. The table shown on page 16 of Respondents' brief is based upon the valuations of the I.C.C. Hence, it is no more authoritative than the plan itself. To use it for the purpose of demonstrating the fairness of the plan is equivalent to hoisting oneself by his own bootstraps.

Further, the table is based upon face value of the securities to be issued. Yet, on page 21 of their brief, the Respondents concede that the securities in the plan, originally intended to be issued to holders of C & M bonds, would sell at far more than par. *This concession, in itself, is sufficient to warrant a revision of the plan.*

By the same reasoning, it is thus demonstrated, as Petitioners have contended, that the General Mortgage with 112% of their claims satisfied under this approved pre-war plan are also overcompensated.

E. Respondents accuse the Petitioners of misquoting or misinterpreting the record in contending that the I.C.C. stated that payment of the R.F.C. claims would necessitate material modification in the plan. A re-reading of the pertinent portion of the record indicates no such misquoting or misinterpretation. That is what the Commission said. Petitioners believe the Commission meant what it said.

F. Respondents' entire argument concerning Petitioners' *Specification 5* (pages 16-18 of their brief) is based upon the alleged deficiency. Petitioners claim that, in view of the changed situation showing indisputable tremendous cash and securities accumulations and sharp reduction of funded debt and annual, fixed charges, the Commission should be given the opportunity to determine now whether such deficiency does actually exist. It is also based upon the fallacious theory that funds earned by the debtor during the period of reorganization belongs to the secured creditors. Petitioners claim that net profits, as distinguished from moneys obtained from the sale of a mortgaged asset, belong to the general fund, and as such, are subject to be ratably shared by all creditors, secured or unsecured.

G. The Respondents' brief assumes that the Petitioners complain of the changes made in the plan by the Commission after certification of it by the Commission to the Court. On the contrary, Petitioners' objection is that material changes were made by the Court, not the Commission, contrary to the provisions of Section 77 of Bankruptcy Act, thereby denying the Commission the opportunity of revising the plan in the light of such changes.

The indisputable fact is that an entire class of creditors consisting of the Chase Bank and the R.F.C. loans were eliminated by the District Court. This is contrary to the terms of the plan as contemplated by the Commission's report (R. 234) and requires recasting by the Commission.

It is true that petitioners, the Convertible Bondholders Group, made more proposals than the one to pay off the Bank-R.F.C. loans (R. 230). The Commission speaks of all together as "Convertible Bondholders Group's *proposals*". Similarly, it refers to the "Debtor's *proposals*". It discusses and disapproves these proposals one by one until only the proposal to pay the loans is left. In discussing that the Commission said (R. 234):

> "The approval of either the debtor's *proposal* or the Convertible Bondholders' Group's *proposal* would necessitate material modification in the plan and, in our opinion, is not warranted." (Italics supplied.)

Neither Article XVII nor Article XXII of the plan can be construed to authorize the Court to vary the plan as it did. Article XVII makes provision for payments on claims. It was never intended to cover payment of an entire creditor class. It speaks of reducing the amount of the claim, not eliminating it entirely (R. 28-29). It may be that the Commission had the R.F.C. in mind when it considered Article XVII. But its later discussion (R. 256-257) clearly indicates partial payments are intended, not full payment and total elimination of an entire class of creditors. The saving clause, Article XXII (R. 30) quoted on page 21 of Respondents' brief, permits the Court to make minor adjustments to carry out the plan as approved by the Commission. It certainly is not intended to authorize the Court to make basic changes in the plan itself. In fact, any such delegation of authority would violate the provisions of the Bankruptcy Act and would be illegal.

> Bankruptcy Act, Sec. 77, Subsection (d);
> *Ecker* v. *Western Pac. R'y. Co.*, 318 U. S. 448.

H. Respondents' brief, pages 21 and 22, alleges that the Circuit Court did not deny itself the power to review the valuation of the Commission. Attention is respectfully directed to the following portion of the Opinion of the Circuit Court (R. 347):

> "The debtor, appropriately, does not question the valuations of the Commission. It contends, however, that the Commission erred as a matter of law when it reduced the total capitalization from $368,127,410 to $356,117,327 in the modified plan here on review. It says that because the Commission determined the debtor's assets at one figure, it is precluded from reconsideration unless there has been a new determination of the fair value of assets. Otherwise, the debtor argues, the fund to be divided among the creditors could be reduced indiscriminately.
>
> "In so arguing, it seems to us that the debtor overlooks the point that any determination of total capitalization is in itself a valuation *which, concededly, is not subject to review.*" (Emphasis supplied.)

I. Cash distribution was made to the Convertible Bondholders to the extent of $406,482 out of a total of $50,421,522 in cash and new first mortgage bonds or less than 4/5ths of 1% of the securities and cash available. Even accepting the basis of Respondents' argument, to wit, that they are entitled to 90% of all cash earned by the trust estate, it becomes obvious by the Respondents' own admission that this formula was not followed (Respondents' Brief, pp. 24-25).

However, the earnings of the estate are part of the general fund of the Debtor and hence, not allocable only to senior debt. In fact, under the decision of this honorable Court in *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Railway Co.*, 294 U. S. 648 (1935), it was specifically held that Respondents have no *lien* on property of the Debtor in a plan of reorganization

but only the right to compensation in new securities. But even if such a lien did exist it would not extend to earnings made possible by the mortgaged property because the earnings generated by the mortgaged property do not dilute or depreciate the value of the security.

J. The answer relating to *Specification 10* (Respondents' Brief, p. 25), is also fallacious. Refusal to consider Petitioners' petition for rehearing by the Circuit Court of Appeals is discretionary, but as we have shown above (p. 3), the petition was, in fact, entertained and not dismissed but only denied. Moreover, stay of mandate to permit review by this honorable Court was intended and specifically provided for by the same order of the Court.

The cancellation of hearings by the Commission pending the appeal from the order remanding the plan, does not affect the basic fact that the last judicial appraisal of the plan resulted in a finding of unfairness and inequity recognized by the District Court and the Commission as reflected in the District Court's order denying confirmation of the plan and the Commission's order reopening this proceeding and assigning it for public hearing for the consideration of modifications to, or the presentation of, new plans. That public hearing has not been held due to Respondents' periodic petitions for postponement.

It is not the intention of the Petitioners to delay the proceedings uselessly. Actually, a constructive proposal which will permit payment of the General Mortgage creditors and full satisfaction of the remaining unsatisfied senior claims has already been submitted by Petitioners and is on file with the Commission.

Finally, this honorable Court's attention is directed to the fact that *the basis of the plan is already materially changed by reason of the substantial reduction of annual fixed charges provided for in the plan* (*Petitioners' Brief, p. 26*). This is an actual and not a theoretical situation

upon which Petitioners fail to comment and which is unanswerable and must be recognized by this honorable Court.

The physical existence of huge amounts of cash and securities in the trust estate has not and cannot be denied.

In identical circumstances the *senior* creditors in the Missouri-Pacific Railroad reorganization have this day petitioned the Circuit Court of Appeals, 8th Circuit to remand an approved plan of reorganization to the Interstate Commerce Commission for revision.

The present Rock Island plan should, therefore, be remanded and revised to permit increased participation by junior creditors on a basis which is just and fair and equitable.

CONCLUSION

The petition for writ of certiorari and for the relief sought by Petitioners should be granted.

Dated, January 27, 1947.

Respectfully submitted,

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INDEX.

PAGE

STATEMENT 2

ARGUMENT

1. The time for filing the petition has expired, and this Court is therefore without jurisdiction to entertain the petition..... 4

2. There is no merit to the contention that the petitioners were denied a hearing on their objections to the plan of reorganization, since the objections in question related to a controversy between them and the Chase National Bank which was then *res adjudicata* and has since become moot..... 10

3. The other questions sought to be presented are without merit..... 13

CONCLUSION 26

Table of Cases.

	PAGE
Chicago, Rock Island & Pacific Railway Co. v. *Fleming, et al.*, 7 U. S. Sup. Ct. Bul. 46 (1946)	3
Commissioner of Internal Revenue v. *Estate of Bedford*, 325 U. S. 283 (1945)	9
Continental Illinois National Bank & Trust Co. v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648 (1935)	26
In re Denver & R. G. W. R. Co., 150 F. (2d) 28 (1945)	4
Ecker v. *Western Pacific R. Corp.*, 318 U. S. 448 (1943)	15
Fleming v. *Traphagen*, 7 U. S. Sup. Ct. Bul. 296 (1946)	3
Group of Investors v. *Chicago, Milwaukee R. Co.*, 318 U. S. 523 (1943)	15
Gypsy Oil Company v. *Escoe*, 275 U. S. 498 (1927)	6
Harrison et al. v. *Fleming et al.*, 7 U. S. Sup. Ct. Bul. 46 (1946)	3
Leishman v. *Associated Wholesale Electric Co.*, 318 U. S. 203 (1943)	8
Market Street Railway Co. v. *Railroad Commission of California*, 324 U. S. 548 (1945)	8
Pfister v. *Northern Illinois Finance Corp.*, 317 U. S. 144 (1942)	7
Reconstruction Finance Corporation v. *Denver & R. G. W. R. Co.*, 66 S. Ct. 1282 (1946)	13, 15, 17, 19, 22
Zimmern v. *United States*, 298 U. S. 167 (1936)	8

Statutes.

Bankruptcy Act, Section 39(c)	7
Judicial Code,	
Section 8(a)	5, 9
Section 8(c)	8

FEDERAL RULES OF CIVIL PROCEDURE FOR DISTRICT COURTS OF THE UNITED STATES.

PAGE

Rule 6(b), 28 U. S. C. A. following §723c 8

COURT RULES.

Rule 22 of United States Circuit Court of Appeals for the Seventh Circuit 4, 5

OPINIONS BELOW.

In re The Chicago, Rock Island and Pacific Railway Company (N. D. Ill. E. D., May 14, 1945) (unreported).

Chicago, R. I. & P. Ry. Co. v. *Fleming*, 157 F. (2d) 241 (C. C. A. 7th, 1946).

Supreme Court of the United States

OCTOBER TERM, 1946.

IN THE MATTER
of
THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,
Debtor.

GERALD AXELROD, *et al.*, constituting a Group of Individual Owners of the 4½% Convertible Gold Bonds of the above-named Debtor,
Petitioners,

vs.

JOSEPH B. FLEMING AND AARON COLNON, as Trustees of The Chicago, Rock Island and Pacific Railway Company, *et al.*,
Respondents.

No. 791.

BRIEF OF RESPONDENTS:

1. METROPOLITAN LIFE INSURANCE COMPANY, AS REMAINING MEMBER OF THE FIRST AND REFUNDING GROUP,
2. TRUSTEES UNDER THE FIRST AND REFUNDING MORTGAGE,
3. TRUSTEE IN RESPECT OF THE SECURED 4⅛% BONDS, SERIES A,
4. PROTECTIVE COMMITTEE FOR THE GENERAL MORTGAGE BONDS,
5. TRUSTEES UNDER THE GENERAL MORTGAGE,
6. PROTECTIVE COMMITTEE FOR THE ROCK ISLAND, ARKANSAS AND LOUISIANA RAILROAD COMPANY FIRST MORTGAGE 4½% BONDS,
7. PROTECTIVE COMMITTEE FOR CHOCTAW, OKLAHOMA AND GULF RAILROAD COMPANY CONSOLIDATED MORTGAGE 5% BONDS AND CHOCTAW AND MEMPHIS RAILROAD COMPANY FIRST MORTGAGE 5% BONDS,

IN OPPOSITION TO PETITION OF CERTAIN CONVERTIBLE BONDHOLDERS FOR A WRIT OF CERTIORARI.

Statement.

Certain holders of an aggregate of less than $400,000 (out of a total issue of more than $32,000,000) principal amount of unsecured 4½% Convertible Bonds of The Chicago, Rock Island and Pacific Railway Company have belatedly applied to this Court for a writ of certiorari to review the order and decree of the United States Circuit Court of Appeals for the Seventh Circuit, entered on May 23, 1946, which affirmed the order of the United States District Court for the Northern District of Illinois entered on June 15, 1945, approving the modified plan of reorganization for the Rock Island System certified by the Interstate Commerce Commission to the District Court on May 1, 1944.*

Also on May 23, 1946, the Circuit Court of Appeals entered an identical order in three other appeals (Nos. 8929, 8930 and 8931) from the order of the District Court approving the plan, taken, respectively, by the Debtor, the Protective Committee for the Debtor's Preferred Stock, and the Indenture Trustee for the Little Rock & Hot Springs Western Bonds. These appeals, together with the appeal of the individual Convertible Bondholders, were heard and determined together but were not consolidated.

This Court, on November 18, 1946, denied petitions for writs of certiorari filed by two of the appellants in the

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* In the proceedings on the plan before the Commission and the District Court, the interests of the unsecured Convertible Bondholders were actively and vigorously represented by The Chase National Bank of the City of New York, as Trustee under the Indenture pursuant to which such Bonds were issued. The said Trustee did not appeal from the order of the District Court approving the plan, but the attorneys for the petitioning individual bondholders, who have throughout the proceeding been endeavoring to assert collateral and irrelevant claims against that Trustee, have filed this petition on behalf of the holders of approximately 1.2% of the Bonds of that issue.

above mentioned appeals, viz., the Debtor (Docket No. 410) and the Preferred Stock Committee (Docket No. 524).* *Chicago, Rock Island & Pacific Railway Co.* v. *Fleming et al.* and *Harrison et al.* v. *Fleming et al.*, 7 U. S. Sup. Ct. Bul. 46 (1946).

We respectfully submit that the petition of these Convertible Bondholders for a writ of certiorari should also be denied for the following reasons:

1. The time for filing the petition has expired, and this Court is therefore without jurisdiction to entertain the petition;

2. There is no merit to the contention that the petitioners were denied a hearing on their objections to the plan of reorganization, since the objections in question related to a controversy between them and the Chase National Bank which was then *res adjudicata* and has since become moot; and

3. The other questions sought to be presented are without merit.

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* A petition for a writ of certiorari to review a separate order of the Circuit Court of Appeals for the Seventh Circuit, entered on June 17, 1946, was filed by the Debtor. That order did not affect the plan of reorganization. The order determined that the holders of Choctaw and Memphis Bonds were entitled to receive interest on unpaid interest which had accrued during the reorganization proceedings. The petition for a writ of certiorari was granted and the order of the Circuit Court of Appeals was reversed by this Court on December 16, 1946. *Fleming* v. *Traphagen*, 7 U. S. Sup. Ct. Bul. 296. A petition for reconsideration has been filed and is pending.

Argument.

1. The time for filing the petition has expired, and this Court is therefore without jurisdiction to entertain the petition.

The opinion and order sought to be reviewed were entered by the Circuit Court of Appeals on May 23, 1946 (Add. R. 94, 109*). Thereafter, on June 7, 1946, a petition for rehearing was filed in cause No. 8929 by the Preferred Stock Committee, and in cause No. 8938 by the individual Convertible Bondholders, the petitioners herein (Add. R. 110). On June 20, 1946, the Circuit Court of Appeals entered its order in causes Nos. 8929 and 8938 denying both petitions for rehearing (Add. R. 111).**

These petitions for rehearing were filed within fifteen days after the entry of judgment on May 23, 1946, as required by Rule 22 of the Circuit Court of Appeals for the

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* References so indicated are to the Additional Transcript of Record filed herein by the petitioners. Pages 1-92, inclusive, of such Additional Transcript of Record are printed as an appendix to the brief, dated March 12, 1946, of these petitioners before the Circuit Court of Appeals; pages 93-153 thereof are contained in the separately printed paper entitled, "Additional Transcript of Record" filed herein. References indicated by "R. ....." are to the transcript of record on the Debtor's petition for a writ of certiorari (Docket No. 410, October Term, 1946).

** Also on June 20, 1946, the Circuit Court of Appeals entered an order in all four causes (Nos. 8929, 8930, 8931 and 8938) amending its opinion filed May 23, 1946, by striking out one paragraph (the first full paragraph appearing at Add. R. 104). This amendment was on an immaterial matter. In the paragraph eliminated, the Circuit Court of Appeals had distinguished the decision of the Circuit Court of Appeals for the Tenth Circuit in *In re Denver & R. G. W. R. Co.*, 150 F. (2d) 28 (1945). After the opinion of the Circuit Court of Appeals in the present case had been rendered, this Court reversed the decision in the *Denver and Rio Grande* case, thereby making superfluous the paragraph which was eliminated.

Seventh Circuit.* The time within which these Convertible Bondholders might have applied for a writ of certiorari therefore commenced to run from June 20, 1946, the date when their first petition for rehearing was denied. Under Section 8(a) of the Judicial Code (43 Stat. 940 (1925), as amended, 28 U. S. C., §350 (1941)), their time for filing such a petition expired on September 20, 1946, i. e., three months after the entry of the order on June 20, 1946 denying the first petition for rehearing.** However, the present petition was not filed until December 17, 1946.

On September 10, 1946, these individual Convertible Bondholders filed a second petition for rehearing. No leave to file this petition was requested or granted, although the time prescribed by Rule 22 of the Circuit Court of Appeals for filing such a petition had long since expired. The petition was denied without opinion by an order entered on September 18, 1946 (Add. R. 148-149).

The present petition for a writ of certiorari, filed on December 17, 1946, was filed exactly one day short of three

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* Rule 22 of the Circuit Court of Appeals for the Seventh Circuit reads as follows:

> "Printed petition for rehearing may be filed within 15 days after entry of judgment, and shall be served forthwith by copy upon the opposing party, who within 10 days from such service, may file a printed answer, and the petition shall be determined without oral argument unless otherwise ordered. Thirty copies of such petition and answer shall be filed with the clerk of this court."

** Section 8 (a) of the Judicial Code reads as follows (43 Stat. 940 (1925), as amended, 28 U. S. C. §350 (1941)):

> "No appeal, or writ of certiorari, intended to bring any judgment or decree before the Supreme Court for review shall be allowed or entertained unless application therefor be duly made within three months after the entry of such judgment or decree, excepting that writs of certiorari to the Supreme Court of the Philippine Islands may be granted where application therefor is made within six months. For good cause shown either of such periods for applying for a writ of certiorari may be extended not exceeding sixty days by a justice of the Supreme Court."

months after entry of the order denying the second petition for rehearing, and nearly six months after denial of the first petition for rehearing. It is apparent that the purpose of the attorneys for the petitioners is to cause as much delay as possible. Nothing else can explain their filing a second petition for rehearing nearly three months after their time to file a petition for a writ of certiorari had begun to run, and then after the denial of their second petition for rehearing, waiting almost another full three months before filing this application for certiorari.

We submit that there is no question, under the decisions of this Court, that these individual Convertible Bondholders cannot, by the filing of a second petition for rehearing long after the expiration of the period allowed therefor, and without obtaining leave to file the petition late, enlarge their time for filing a petition for a writ of certiorari in this Court.

In *Gypsy Oil Company* v. *Escoe,* 275 U. S. 498 (1927), the controlling principles of law were stated as follows, at pages 498-499:

> "The running of the time within which proceedings may be initiated here to bring up judgment or decree for review is suspended by the seasonable filing of a petition for rehearing. But it begins to run from the date of denial of such petition and further suspension can not be obtained by the mere presentation of a motion for leave to file a second request for rehearing. [Citation omitted.]
>
> "If, however, a timely motion for leave to file the second petition is granted, and the petition is actually entertained by the Court, then the time within which application may be made here for certiorari begins to run from the day when the Court denies such second petition."

If the time for filing a petition for certiorari is not extended by the presentation of a motion for leave to file a second application for rehearing, it follows *a fortiori* that the time is not extended when a second petition for rehearing is filed long after the time for filing such a petition had expired and without any request whatever for leave to file the second petition for rehearing.

Pfister v. *Northern Illinois Finance Corp.*, 317 U. S. 144 (1942), instead of supporting the petitioners (Petition, p. 15), clearly shows that the present petition has been filed too late. In that case it was held that the denial of two successive petitions for rehearing of a referee's order, both petitions having been filed after expiration of the statutory period for review, did not extend the time for filing a petition for review under Section 39(c) of the Bankruptcy Act. 30 Stat. 555 (1898), as amended, 11 U. S. C. §67(c) (1941). This Court stated (at pp. 149-150) that where a petition for rehearing is granted and the issues of the original order are re-examined and an order is entered, either denying or allowing a change in the original order, the time for review under Section 39(c) begins to run from that entry. But where an out of time petition for rehearing is filed and the court merely considers whether the petition sets out, and the facts—if any are offered—support, grounds for opening the original order, and determines that no grounds for a re-examination of the original order are shown, the examination of the grounds for allowing a rehearing does not enlarge the time for review of the original order. This result was held to follow from the well established rule that where an untimely petition for rehearing is filed which is not entertained or considered on its merits the time to appeal from the original order is not extended.

In the present case the petition for rehearing was not granted, but was summarily denied. The Court rendered no opinion, and it does not appear that the issues decided by the original order were re-examined. Consequently, the time for filing this petition was not extended.

None of the other decisions cited by the petitioners in an effort to show that their petition for certiorari is timely are in point (Petition, p. 15). Thus in *Market Street Railway Co.* v. *Railroad Commission of California,* 324 U. S. 548 (1945), a timely appeal was taken from a judgment of the California Supreme Court after the denial of a timely petition for rehearing. It was held that the appeal was not premature merely because the local rules provided that a decision of the Supreme Court did not become final until thirty days after the filing of the decision. No issue was involved concerning the enlargement of the time for review by reason of the denial of the petition for rehearing.

In *Leishman* v. *Associated Wholesale Electric Co.,* 318 U. S. 203 (1943), it was held that a notice of appeal was in time where it was filed within the period specified by 28 U. S. C. §230 after the denial by a district court of a motion to amend and supplement the findings of fact and conclusions of law. In that case, however, the motion for such amendment had been made within the allowed period after obtaining an enlargement of time under Rule 6(b) of the Rules of Civil Procedure (28 U. S. C. A. following §723c).

In *Zimmern* v. *United States,* 298 U. S. 167 (1936) it was held that an order entered by a district court, on its own motion and during the same term of court, substantially amending a previous order of the court, extended the time for filing a notice of appeal. This decision has no relevance here.

The petitioners make the further argument that their time for filing this petition should be computed from Sep-

tember 18, 1946, the date of entry of the order denying their second petition for rehearing, because that order also continued a stay of the Court's mandate which had been granted by previous orders (Add. R. 113, 114) "until the disposition of the petitions for writ of certiorari in the Supreme Court of the United States" (Add. R. 148-149). In support of this argument they cite *Commissioner of Internal Revenue* v. *Estate of Bedford,* 325 U. S. 283 (1945).

This contention is without substance. The stay of the Court's mandate is not the judgment to be reviewed, and does not again put in issue the matters determined by the judgment, as does a petition for rehearing. In the present case the judgment order sought to be reviewed is the order of affirmance entered May 23, 1946 (Add. R. 109).

The *Bedford* case, holding that the time for filing a petition for a writ of certiorari to review a judgment of the Circuit Court of Appeals for the Second Circuit should be computed from the date of entry of the "order for mandate," was based upon the special practice and the common understanding prevailing in the Second Circuit by which the order for mandate is deemed the judgment order, and has no application to proceedings to review decisions of the Circuit Court of Appeals for the Seventh Circuit. Even so, this Court criticized the procedure of the Circuit Court of Appeals for the Second Circuit, saying (325 U. S. 283, at p. 288) that the normal time for entering a judgment, as the starting point for determining whether review will be sought or whether there has been acquiescence in the judgment, should be fixed, and that the uncertainties inherent in litigation should not be needlessly prolonged by a "variable and vagrant practice" with respect to entering the order for mandate.

Accordingly, the present petition for a writ of certiorari should be denied because not filed within the time allowed by law. Judicial Code, Section 8(a), 43 Stat. 940 (1925), as amended, 28 U. S. C., §350 (1941).

2. There is no merit to the contention that the petitioners were denied a hearing on their objections to the plan of reorganization, since the objections in question related to a controversy between them and the Chase National Bank which was then *res adjudicata* and has since become moot.

The petitioners' contention that they were denied a hearing by the District Court on their objections to the plan rests upon that Court's refusal to consider objections based upon a stale controversy between them and the Chase National Bank (Petition, pp. 16-17, 19-20). The contention is completely without merit. There is no possible basis for these petitioners to seek to revive that controversy here, since it is both *res adjudicata* and moot.

The Chase National Bank of the City of New York is Trustee under the Indenture relating to the unsecured Convertible Bonds and also, along with four other banks and Reconstruction Finance Corporation,* held collateral for loans made to the Debtor.

In 1940, these petitioners filed in the District Court their statement of a claim against the Chase Bank, the other banks and the R. F. C. The banks moved to dismiss the statement of claim as stating no cause of action against them, and that motion was granted on December 10, 1940. An appeal was taken by these petitioners from that ruling, but was not prosecuted and was dismissed for that reason by the Circuit Court of Appeals for the Seventh Circuit on October 3, 1941.

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* The other four banks were Continental Illinois National Bank and Trust Company of Chicago, Harris Trust & Savings Bank, Mississippi Valley Trust Company and The New York Trust Company.

Certain of the facts referred to in this point are not part of the record on this petition. They are, however, a part of the record of proceedings before the District Court and before the Circuit Court of Appeals on other appeals, and the petitioners cannot dispute them.

Thereafter, in 1941, these petitioners sought to revive this claim, which had already been dismissed, by including it in their objections to the plan certified by the Commission to the District Court on July 31, 1941 (pp. 4-8 of document following p. 50 of Appendix to Convertible Bondholders brief, dated March 12, 1946, before Circuit Court of Appeals (Add. R. 50)). The attorneys for Continental Illinois National Bank and Trust Company moved to strike this reiteration of the claim, and the District Court said at the argument of the motion on October 13, 1941 (Steno. Tr., pp. 72-74):

> "The Court: As I understand, we argued this a long while ago and you folks had an opportunity to appeal from the order and you did not see fit to do so. You could have had this reversed a long time ago. You are not going to litigate this here again.
>
> "Mr. Kirshbaum: I don't propose to. I want to point out to your Honor that at that time your Honor said—if I misunderstood, your Honor will correct me—that our petition was premature.
>
> "The Court: I don't recall that I said anything like that. There was a motion to strike and I sustained the motion."
>
> • • • • • •
>
> "Mr. Kirshbaum: Yes, it was a motion to dismiss our petition, as I understand it, for insufficiency.
>
> "Mr. Friedlich [of Counsel for Continental Illinois National Bank and Trust Company]: You did not state a cause of action.
>
> "Mr. Kirshbaum: Please, may I finish?
>
> "Mr. Friedlich: Sure.
>
> "Mr. Kirshbaum: As I understand it, your Honor never passed on the merits of that thing at all, your Honor simply passed on the petition as such.
>
> "Mr. Friedlich: How can his Honor pass on the merits if it does not state a cause of action in the first place?

"Mr. Kirshbaum: That is it exactly. In other words, at that time maybe our petition was premature.

"The Court: I did not say so.

"Mr. Kirshbaum: Well, the question in my mind is——

"The Court: I read over the different exhibits that were handed to me and I listened to the arguments, and I came to the conclusion that you did not have any right of action."

After that discussion, and on the same day, an *agreed* order was entered striking the allegation of this claim from the objection. This agreement is shown on page 11 of the document following page 50 (Add. R. 50) of the Appendix to the brief of these petitioners before the Circuit Court of Appeals. It there appears that these claims were stricken from the objections upon written agreement signed by the attorneys for these petitioners.

It is therefore impossible to understand how the attorneys for these petitioners can now advance as a ground for this petition (Petition, p. 17) the claim that they were denied a hearing on the very objections which they stipulated in writing should be deleted. It is equally impossible to understand how they can bring themselves to base their present application for review on an alleged claim against the Chase Bank when that claim has been finally adjudicated against them and they have never prosecuted their appeal from the order dismissing it.

But that is not all. In 1943 the Chase Bank made an application to the District Court to be relieved of the injunction preventing the sale of the collateral which it held. The District Court granted the application and vacated the injunction, the Chase Bank agreeing that it would make no claim against the Rock Island estate for any deficiency

owing to it after crediting the proceeds of the sale (R. 313). No appeal was taken by these petitioners or by anyone else from this order lifting the injunction as against the Chase Bank, or from the similar orders lifting the injunction as against the other banks. The banks, including the Chase Bank, sold their collateral, as the attorneys for these petitioners assert (Petition, p. 6), and as appears from the entry which the Rock Island then made on its books reflecting the sale (Add. R. 49—Appendix to petitioners' brief before Circuit Court of Appeals, p. 49). That sale necessarily made moot, in this proceeding, the alleged claim of these petitioners against the Chase Bank.

In any event, whatever the claims of these petitioners against the Chase Bank may be, why should they pursue the other creditors, who have nothing to do with this controversy, and burden this Court with a stale, moot claim which has been finally decided against these petitioners?

3. **The other questions sought to be presented are without merit.**

The Convertible Bondholders, on pages 16 to 18 of their petition and supporting brief, list eleven specifications of errors. Some of the contentions there advanced are the same as those made by the Debtor and by the Preferred Stock Committee, whose petitions for certiorari (Dockets Nos. 410 and 524) have been denied by this Court. Furthermore, most of the petitioners' contentions are disposed of adversely to them by this Court's decision in *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 66 S. Ct. 1282 (1946). None of the questions sought to be presented is meritorious.

The specifications of errors will be briefly discussed in the order in which they are listed by the petitioners.

As to Specifications 1 and 2. These specifications, based upon the petitioners' controversy with the Chase Bank, have already been considered in Point 2 above. We merely note here that the Circuit Court of Appeals made no such ruling as that attributed to it in Specification 1 (Petition, p. 16). That Court merely ruled, and correctly so, that the petitioners' controversy with the Chase Bank had no relation to the merits of the plan of reorganization, which was the question before the Court (Add. R. 107-108).

As to Specifications 3 and 4. The petitioners seek to challenge the determination that the plan is fair and equitable and affords due recognition of the rights of the Convertible Bondholders (Petition, p. 17).

First, they seek (Petition, pp. 22-24) to attack the capitalization approved by the Commission in its May 1, 1944 order certifying the plan to the District Court (R. 249). They complain that the 1944 capitalization of $356,000,000 was approximately $12,000,000 lower than the 1941 capitalization of approximately $368,000,000 originally approved by the Commission (R. 162, 167).

The petitioners ignore, in this connection, the fact that in addition to the $356,000,000 approved capitalization, more than $38,000,000 in cash was allocated among the creditors by the 1944 plan (R. 249-250, 259).

Furthermore, the decrease of $12,010,830 in the approved capitalization was the net result of the reduction of $13,034,916 in equipment obligations between January 1, 1942, the former effective date of the plan, and January 1, 1944, the new effective date of the plan, and the increase of $1,024,833 in new common stock provided for in the plan (R. 250). The Commission recognized that the amount of equipment obligations of a railroad are subject to fluctuation upward as well as downward, and found that it would not be warranted in increasing the amounts of new securities to any greater

extent than it did (R. 250). Obviously leeway should be left to finance the acquisition of new equipment in the future. Moreover, the reduction of fixed charges resulting from the retirement of equipment obligations was found to be adequately reflected in the provision for more than $1,000,000 of additional new common stock (R. 250). These adjustments, based upon judgments in a field in which the Commission has a special competence, were within the power of the Commission to make and present no legal issues warranting review by this Court. *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 66 S. Ct. 1282, 1289 (1946); *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 468, 474 (1943); *Group of Investors* v. *Chicago, Milwaukee R. Co.*, 318 U. S. 523, 544-545 (1943).

A further reason for the reduction of the approved capitalization is apparent from the face of the two plans. The 1941 plan provided for the issuance of $11,000,000 of new first mortgage bonds, constituting part of the $368,000,000, for $11,000,000 of new money to go into the System (R. 145). The 1944 plan distributed these $11,000,000 of bonds to the creditors, with the result that new money in the amount of $11,000,000 would not come into the System (R. 234, 259). Consequently, a capitalization of approximately $11,000,000 less under the second plan was clearly justified.

The petitioners further complain (Petition, p. 8) of the allocation of $38,011,922 in cash and $12,409,600 of new first mortgage bonds in addition to the allocations made by the Commission in the plan approved by its July 31, 1941 report, contending that these allocations were in addition to 100% satisfaction of the secured creditors' claims.

The fallacy of this contention is that it assumes that the creditors were paid in full by the allotment of securities made in the Commission's first plan. That the secured creditors would not have been paid in full by such allot-

ments is obvious from the fact that their claims are nowhere near satisfied in full even by the allotments under the Commission's modified plan, including the cash allotments. The secured creditors of the Rock Island, together with the amounts of their claims at the effective date of the plan, i. e., January 1, 1944, and the deficiencies in their claims remaining after receipt of the new securities and cash allocated to them under the plan (R. 259), are shown by the following table. The deficiencies are shown when calculated by taking new no par value common stock at $100 per share, and also by taking such stock at $50 per share, the amount which it has been adjudicated by the Commission and the District Court to be worth in determining that the General Mortgage Bonds are wholly satisfied and will have no deficiency under the present plan (R. 237-243, 252-254, 301-302).

Secured Claims	Claim at Jan. 1, 1944	Deficiency taking new common at $100	Deficiency taking new common at $50
General Mortgage	$ 86,213,400	$ None	$ None
C. & M. First Mortgage	5,286,000	None	None
First and Ref.	156,870,859(A)	28,628,683	57,606,900
Secured 4½s	59,021,174	6,760,283	18,569,382
C. O. & G.	8,296,867	358,746	872,239
St. P. & K. C. S. L.	27,495,118(A)	8,108,509	13,404,485
R. I. A. & L.	16,362,500	3,384,223	5,922,916
B. C. R. & N.	16,912,500	6,634,467	9,539,383
Total	$376,458,418	$53,874,911	$105,915,305

(A) Includes bonds now outstanding, formerly pledged for bank loans.

As to Specification 5. This specification relates to the payment of the R. F. C. loan, pursuant to Court order, after the approval of the plan by the Commission (Petition, p. 17).

The petitioners complain of the alleged ruling below that collateral for the R. F. C. loan, which was thus redeemed for the treasury by the use of treasury cash, should remain undistributed (Petition, p. 17). Their contention is appar-

ently stated inaccurately, since the collateral consisted of obligations of the Debtor and its subsidiaries, and it has never been proposed to distribute old securities. In any reasonably likely plan of reorganization this collateral would be cancelled. The petitioners' real objection seems to be to the ruling that there should be no redistribution of the new securities which were allotted in the plan to the R. F. C.

This objection ignores the fact that the cash used to reclaim this collateral was generated from the mortgaged lines; consequently, the collateral and any new securities issuable in respect thereof belong to the unsatisfied mortgage bondholders, not to the unsecured creditors.

Furthermore, the petitioners' objection ignores the fact that an important element of the compensation of senior creditors for their loss of position when part of their claims are satisfied under the plan by the allocation of new common stock is their right, as holders of such stock, to participate in the accumulated assets and in future earnings. As this Court pointed out in *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 66 S. Ct. 1292, 1298 (1946), the use of such assets to retire senior claims is a part of the normal and expected increment from holdings of common stock. When the reduction of senior capital takes place after the adoption of a plan by use of anticipated earnings or existing cash, there can be no readjustment of junior participations, because assets in the balance sheet at the adoption of the plan and subsequent earnings are for the benefit of the stockholders in the new company, so that through these common stock advantages the new stockholders may be compensated for their loss of payment in full in cash.

Distribution of the R. F. C. collateral or the new securities issuable therefor would not benefit the unsecured creditors. As pointed out above (p. 16) there are $105,915,000 of unsatisfied claims of secured creditors. There are only

$28,000,000 face amount of new securities reclaimed from the R. F. C., taking the new common stock at $100 per share, or but $23,000,000, taking such common stock at $50 per share, its value as adjudicated herein (R. 237-243, 252-254, 301-302). While such deficiences exist in the satisfaction of secured creditors' claims, unsecured creditors would not be entitled to the collateral upon a distribution thereof. These petitioners are in fact benefited by leaving the new securities in the treasury, because every creditor in effect now shares in them according to his allocation of new securities, particularly new common stock. That includes the Convertible Bondholders, who are allotted 10.68% of the new common stock (R. 259).

The petitioners' often-reiterated quotation of the Commission to the effect that payment of the R.F.C. claims "would necessitate material modification in the plan" is incomplete and misleading (Petition, pp. 9, 10, 17, 21). The Commission's statement was made not alone with respect to payment of the R.F.C. claims, but with reference to the proposals of these Convertible Bondholders for modification of the plan (R. 233-234). These Bondholders called for a compromise of the claims of the banks and the R.F.C. and suggested, in addition, changes of the plan in several important respects (R. 230). Obviously, to adopt the proposals would have required modification of the plan; but the proposals were not accepted (R. 234).

As to Specification 6. It is contended that the plan was formulated and adopted prior to the commencement of the war (1937-1940) and is based on depressed earnings of that period (Petition, p. 17).

This is not the fact. The Commission itself stated that it had considered the earnings from 1921 to 1930 and from 1931 to 1939 (R. 139), and also the earnings for 1940 (R. 168). After the remanding of the plan to the Commission,

pursuant to the District Court's order entered June 25, 1943 (R. 299), the Commission held hearings in September, 1943 at which the earnings of the Rock Island System, actual and prospective, were again thoroughly considered. In its supplemental report rendered on January 3, 1944, the Commission expressly referred to the evidence before it of current earnings (R. 245); and its findings in this regard were again affirmed, after petitions for modification, in the Commission's supplemental report issued May 1, 1944 (R. 250). The principal issue then before the Commission was the amount of cash available for distribution among creditors on January 1, 1944—a matter necessarily involving a current appraisal of the financial condition of the Rock Island estate.

When the Commission rendered its report and order of May 1, 1944 the war earnings for the years 1942 and 1943 were known. It is reasonable to suppose that the Commission must have anticipated that war earnings would continue longer than they did, because in May 1944 it was not expected that the war would end as soon as August 1945. There is no basis for contending, therefore, that the Debtor's earnings subsequent to May 1, 1944 have been unexpectedly large. Under these circumstances the creditors who will receive the new common stock are entitled to the benefit of earnings realized after January 1, 1944, the effective date of the plan. *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 66 S. Ct. 1282, 1296 (1946).

As to Specification 7. The petitioners contend that it was error to approve the plan after its alleged alteration in several respects without resubmission to the Interstate Commerce Commission (Petition, p. 17). The claimed alterations of the plan which are complained of are (a) the payment of the R.F.C. loan, and (b) the determination that the

Choctaw and Memphis bonds should remain undisturbed and not affected by the plan (R. 312-313).

The payment of the R.F.C. loan is discussed above (pp. 17-18). There is no substance to the contention that payment of this loan was a material alteration of the plan, since the plan contemplates that some claims might be paid before consummation. Article XVII of the plan is entitled "PAYMENTS ON CLAIMS BEFORE PLAN CONSUMMATED", and expressly provides that in the event that any payment shall be made in respect of a claim prior to the consummation of the plan, securities otherwise distributable in respect thereto shall be withheld and shall be treasury securities (R. 28-29). The record leaves no doubt that the Commission had the possible payment of the R.F.C. claims in mind when this provision was being considered (R. 254-257). In holding the payment of the R.F.C. to be consistent with the plan, the District Court was clearly right when it stated (R. 307-308):

> "If any money used to pay or purchase a claim or bonds were not used in that way, it could be used, either before or after consummation of the plan, for additions and betterments or for the purchase of equipment, and it could be used after the consummation of the plan for the purchase of the securities allotted under the plan for the claims of bonds. It is no more inconsistent with the plan to pay claims or purchase securities before the consummation of the plan than it is to spend the same money for additions and betterments before or after the consummation of the plan, or to purchase securities after the plan is consummated.
>
> "Clearly the payment of a claim or the purchase of securities would not afford a basis for a redistribution of securities allotted under the plan. It would amount merely to appropriating surplus earned since the effective date of the plan to one of the several uses to which it could be applied. All those who have interests, as stockholders of the reorganized com-

> pany in the earned surplus would benefit from such a use of the money consistently with the plan, just as they would if the money were spent for additions and betterments or used after the consummation of the plan to purchase securities. If there were a redistribution of the securities that would not be true."

As for the contention with respect to the Choctaw and Memphis bonds, there are at least two complete answers.

First, the petitioners are not injured by the change and therefore have no standing to complain of it. The petitioners assume that the change was made in order to improve the allotment to the Choctaw and Memphis Bondholders, at the expense of the Convertible Bondholders. That is not the fact. The reason for the change was that the security originally provided for in the plan would sell for far more than par, and thus give the Choctaw and Memphis Bondholders more than they were entitled to (R. 306). Therefore, the treatment of the Choctaw and Memphis bonds was changed to provide that such bonds should remain undisturbed. In doing so the District Court acted under Article XXII of the plan (R. 30), which provides:

> "The construction of the plan by the court shall be final and conclusive. The court may correct any defect, supply any omission, or reconcile any inconsistency in such manner and to such extent as may be necessary or expedient in order to carry out the plan effectively."

Second, the Commission noted this comparatively minor correction of the plan and reflected it in the pamphlet submitting the plan to creditors for their vote (R. 2, footnote 3).

As to Specification 8. The petitioners contend that the Circuit Court of Appeals incorrectly denied itself authority to review "obsolete valuations" in the light of substantial improvements in the Debtor's financial condition (Petition, p. 17).

The Circuit Court of Appeals did not deny itself this power. The facts with respect to the Debtor's earnings and other developments subsequent to the certification of the plan by the Commission were fully presented to the Circuit Court of Appeals. Nothing in that Court's opinion even suggests that the Court felt it was without power to reverse the decision below had developments subsequent to the certification and approval of the plan justified or required such action. There simply had been no developments after the Commission had certified the plan to the District Court in 1944 which warranted reversal of the order approving the plan.

In discussing subsequent developments, the petitioners concede (Petition, p. 24) that war earnings are not a reliable criterion of future earnings, and confine their contentions to the effect of war earnings which have already been realized. The reckless claim is then made that the Debtor's financial condition has improved by $185,241,485.56 between January 1, 1940 and April 30, 1946 (Petition, p. 25).

This figure is arrived at by a patently fallacious computation. The petitioners first refer to an item of $37,246,965.49, allegedly representing total net capital expenditures (Petition, p. 25). Without conceding the correctness of this figure, we should point out that the amount of capital expenditures, actual and anticipated, was before the Commission and must necessarily have entered into its valuation of the property (R. 232). Moreover, capital expenditures necessary to enable the Debtor to maintain its competitive position do not necessarily increase earning power, the primary criterion in determining capitalization for reorganization purposes. *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 66 S. Ct. 1282, 1293, 1295 (1946).

The petitioners next mention an item of $25,411,598.97, said to represent the net decrease in outstanding debt between April 30, 1940 and April 30, 1946 (Petition, p. 25). This must necessarily include part of the reduction of equipment obligations, although no change in the plan on this account would be justified for the reasons discussed above (p. 15). It must also include the payment of the R. F. C. and bank loans. As pointed out above (p. 17), payments of these claims were made possible by the use of earnings which were derived from the mortgaged lines and belonged to the mortgage bondholders. The unsecured creditors are entitled to no benefit from these payments, although they actually do benefit as a result of the allocation to them of approximately 10% of the new common stock (R. 259).

The petitioners also include in their computation an item of $40,310,722.02, said to represent the "value" of the R. F. C. collateral returned to the Debtor's estate (Petition, p. 25). The basis for that figure the petitioners do not reveal. However, the Commission expressly found that the liquidating value of the collateral was less than the amount of the R. F. C. claim, viz., $20,849,015 (R. 204, 245, 259). Moreover, since the claim of the R. F. C. must necessarily be included in the petitioners' figure of $25,411,598.97 as representing the net reduction of outstanding debt, it is a duplication to include also the value of the collateral. Even if the collateral were properly included, which it is not, it was recovered for the estate by the use of income from the mortgaged lines to which the mortgage bondholders are entitled. Its recovery could not benefit the unsecured creditors while the claims of the secured creditors are not fully satisfied.

Finally, the petitioners include a figure of $82,272,199.08 as representing total cash and cash equivalents as of April

30, 1946 (Petition, p. 25). The derivation of this figure likewise does not appear from the record in this proceeding. However, the figure is meaningless, since there must obviously be deducted therefrom current liabilities and necessary reserves. A statement prepared by the Debtor's Trustees and introduced in evidence at the hearings on the question of confirmation of the plan shows, as of June 1, 1946, cash and cash equivalents of $77,563,059. After deducting current liabilities, a working capital reserve of $10,000,000, a reserve of approximately $19,000,000 necessary to service the new securities issuable under the plan, payments of debt and interest to become due in 1946, and payments to be made in 1946 for additions and improvements, the net cash remaining was shown to be only $10,997,108.

As to Specification 9. The petitioners' complaint regarding the allocation of $12,409,600 in new first mortgage bonds and $38,011,922 in cash is not understandable (Petition, p. 18). Since these allocations were made as a part of the plan, how they could be "in direct variance with the provisions of the approved plan" is incomprehensible. Furthermore, the distribution was not made, as the petitioners imply, to the senior creditors alone. The unsecured creditors participated in the cash distribution to the extent of $406,482.

There is no basis for the petitioners' claim that the allocation of the additional new first mortgage bonds and cash violated legal and equitable standards. These allocations were made because of the improvement in the Debtor's cash position subsequent to the Commission's original plan approved by its report dated October 2, 1941. The $12,409,600 of new first mortgage bonds which were redistributed consisted of (1) $1,409,600 of such bonds allocated under the Commission's original plan to holders of Choctaw

& Memphis bonds for unpaid accrued interest to January 1, 1942, and (2) $11,000,000 of such bonds reserved under the original plan for sale or pledge to provide new money which had become unnecessary because of the increase of the Debtor's cash (R. 229). These new first mortgage bonds were distributed to the senior creditors in the same manner as first mortgage bonds had been allocated under the original plan, that is, in proportion to the relative earning power of the various mortgaged lines (R. 234).

The $38,011,922 of cash included (1) $1,762,000 allocated to holders of Choctaw & Memphis bonds for unpaid accrued interest on such bonds to January 1, 1944, the new effective date of the plan; and (2) $36,249,922, which the Commission found would have been available for payment of interest and dividends on the new securities issuable under the plan (R. 235). This surplus cash was likewise distributed among the creditors on the basis of the relative earnings of the various mortgaged properties as determined by the allocation of new securities made in the plan approved by the Commission's report dated May 1, 1944. The cash so distributed was made up of eight years' interest on the new first mortgage bonds, four years' interest on the new income bonds, two years' dividends on the new preferred stock, and a dividend of $2.50 per share on the new common stock. This method of distribution gave effect to the earnings of the Debtor and its cash position during the period when the cash was earned, and was approved by both the Commission and the District Court (R. 235, 244-245, 304).

As to Specification 10. The petitioners complain of the denial of their second petition for rehearing by the Circuit Court of Appeals (Petition, p. 18).

The denial of a petition for rehearing is discretionary and is not reviewable. Furthermore, the second petition for rehearing was not timely (see Point 1 above).

The petitioners themselves recognize (Petition, pp. 27-28) that there is no legal merit to their argument for reversing the order sought to be reviewed merely because the District Court has refused to confirm the plan and because the Interstate Commerce Commission has reopened the proceedings and, at the time the petition was filed, had scheduled further public hearings. We shall not undertake to comment on this argument, except to point out that the Commission, by an order dated December 27, 1946, has cancelled until further notice the hearings previously set for January 7, 1947. The Commission's order, after referring to the pending appeals from the order of the District Court denying confirmation of the plan and remanding the proceedings to the Commission, stated:

> "*It further appearing,* That in view of the aforesaid appeals, further hearings before this Commission upon such matters may not be necessary;".

As to Specification 11. This is merely a general reference to the possibility of there being further errors not identified.

Conclusion.

The individual Convertible Bondholders have failed to make a timely application for a writ of certiorari, and seek to present no question having any substance or merit.

It is fair to assume, in view of the late filing of this petition and the insubstantial character of the contentions made, that a major objective of the petitioners is to obtain further delay in a reorganization which this Court said nearly twelve years ago should be consummated with all possible speed. *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648 (1935).

The petition of the individual Convertible Bondholders for a writ of certiorari should be denied.

Dated January 8, 1947.

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